

**Confidential**

## **Premera Blue Cross**

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### **Update Report on Valuation and Fairness of the Proposed Conversion**

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February 27, 2004

  
The Blackstone Group®

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**Premera Blue Cross**  
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## **I. Summary of Findings**

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## I. Summary of Findings

### INTRODUCTION

*The Blackstone Group ("Blackstone") has prepared the following report to review PREMERA's<sup>(1)</sup> ("Premera" or the "Company") amended Form A Filing (the "Amended Form A Filing") which was filed with the Washington Office of the Insurance Commissioner ("OIC") on February 5, 2004 in connection with the proposed conversion of Premera from a private non-profit health service company to a for-profit company and the subsequent initial public offering contemplated by the Company (the "Transaction").*

- Premera filed its original Form A (the "Original Form A Filing") on September 17, 2002. After conducting its review of the Original Form A Filing, Blackstone submitted a Fairness and Valuation Report on the proposed conversion to the OIC on October 27, 2003 (the "Blackstone Initial Report").
- Premera filed a management equity plan with the OIC on October 17, 2003. Blackstone reviewed the equity compensation plan and summarized its findings in a report dated November 24, 2003 (the "Blackstone Compensation Report").
- Since the date of the Blackstone Initial Report, the OIC, the Washington Attorney General's office and their consultants/advisors (the "Washington Representatives"), in addition to their Alaska counterparts (the "Alaska Representatives")<sup>(2)</sup>, have participated in a number of discussions with the Company on the issues raised in the various Washington and Alaska consultants' reports, including the Blackstone Initial Report and the Blackstone Compensation Report.
  - The Washington Representatives met with the Company on October 22, 2003 to discuss issues raised in the preliminary draft reports of the consultants.<sup>(3)</sup>
  - The Washington and Alaska Representatives held meetings with Premera in Seattle on three separate occasions: (i) December 17 – 19, 2003, (ii) January 5 – 7, 2004 and (iii) January 19 – 23, 2004.
  - The Washington and Alaska Representatives have also held conference calls with the Company on numerous occasions.

Note: Please refer to the Amended Form A Filing for any defined terms not specifically defined in this report.

<sup>(1)</sup> PREMERA is the current holding company of Premera Blue Cross, which is authorized to transact business as a health care service contractor. Pursuant to the Transaction, New PREMERA, a taxable entity, will be formed and will own Premera Blue Cross, Premera Blue Cross Blue Shield of Alaska and the Company's other subsidiaries.

<sup>(2)</sup> The Alaska Representatives are advising the Alaska Department of Insurance ("ADI") and the Alaska attorney general's office.

<sup>(3)</sup> The Washington consultant's draft reports were filed with the Company on October 3, 2003.

## I. Summary of Findings

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### INTRODUCTION (CONT'D)

- In addition, since October 2003, the Washington Representatives have held a number of discussions both internally and together with the Alaska Representatives in order to assess the potential implications of the proposed revisions to the Transaction.
- Although the revised Transaction, as reflected in the Amended Form A Filing by the Company, partially reflects the discussions that Premera has held with both the Washington and Alaska Representatives, neither the OIC, the Attorney General nor their consultants have specifically indicated approval of or recommendation of the revised Transaction.
- The following report supplements the Blackstone Initial Report and the Blackstone Compensation Report and focuses on whether the revised Transaction sufficiently addresses issues raised in the previous reports or raises any additional concerns. As such, this report should be read in conjunction with the Blackstone Initial Report and the Blackstone Compensation Report.

## I. Summary of Findings

### SCOPE OF BLACKSTONE'S WORK

*As part of its review of Premera's conversion, Blackstone has done the following:*

#### Documents Reviewed

- Premera's audited historical financial statements for the years ended December 31, 1997 – 2002 and unaudited financial statement for the year ended December 31, 2003.
- Premera management's projections for 2003 – 2007 provided on March 21, 2003.
- Premera's revised financial outlook for 2003 – 2006 provided on October 17, 2003.
- Premera's most recent budget for 2004 presented to the Company's board of directors on February 11, 2004.
- Minutes from meetings of Premera's board of directors for the years 1997 – 2003.
- The Form A filing application and the Transaction documents related to Premera's proposed conversion to a for-profit company, dated September 17, 2002.
- The Amended Form A Filing application related to Premera's proposed conversion to a for-profit company, dated February 5, 2004.
- Presentations made by Goldman Sachs, including those dated September 10, 1997, November 12, 1997, September 9, 2000, May 24, 2001, August 8, 2001 and October 6, 2002.
- The initial reports analyzing various aspects of the Transaction prepared by the consultants / advisors representing Washington, Alaska and the Company and submitted in October / November 2003.
- Drafts of the Washington Representatives' supplemental reports analyzing various aspects of the Amended Form A Filing.
- Certain other publicly available and internal information concerning the business, financial condition, and operations of Premera that we believe to be relevant to our inquiry.

## I. Summary of Findings

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### SCOPE OF BLACKSTONE'S WORK (CONT'D)

#### Meetings / Conference Calls

- Discussed Premera's original Form A to review concerns raised in the reports of the Washington and Alaska Representatives, on several occasions, with both the advisors and the members of management of Premera.
- Discussed the Amended Form A Filing with the Washington and Alaska Representatives.
- Discussed Premera and its business, operating environment, financial condition, prospects and strategic objectives on several occasions with both the advisors and the members of management of Premera.
- Discussed Premera and its business, operating environment, financial condition, prospects and strategic objectives on many occasions with the OIC and ADI and their other consultants, advisors and counsel.

#### Other

- Analyzed the market performance of other conversions and initial public offerings in the health insurance industry.
- Analyzed the operating and trading statistics of selected publicly traded managed care companies.
- Prepared and analyzed various sensitivities to management's projections.<sup>(1)</sup>
- Reviewed such other information, performed such other studies and analyses, and took into account such other matters as we deemed appropriate.

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<sup>(1)</sup> Blackstone, in conjunction with PricewaterhouseCoopers, prepared a sensitivity case to evaluate alternative scenarios regarding projected operating results.



## I. Summary of Findings

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### SCOPE OF BLACKSTONE'S WORK (CONT'D)

*Blackstone has not:*

- Independently verified the accuracy and completeness of financial and other information that is available from public sources and information provided to us by Premera or their respective representatives, or otherwise reviewed by us.
- Made an independent appraisal of Premera's surplus or assets or expressed any opinion as to either the value of such surplus or such assets or the value of the projected income and cash flow expected to be derived therefrom.
- Performed due diligence on Premera's physical properties, sales, marketing, distribution or service organizations, product markets, or investment portfolio.
- Examined or incorporated any findings that may be part of documents deemed to be attorney-client privileged as determined by the Special Master's Decision Following In Camera Review of Documents (Docket No. G02-45).
- Considered any documents or analysis submitted by Premera after February 23, 2004.
- Considered any discussions with Premera or its advisors, which took place after February 23, 2004.
- Expressed any opinion, including as to the following:
  - The fair value of Premera
  - The fair value of the public assets of Premera that serve health care needs in Washington
  - Whether the terms of the Transaction fairly distribute the value of the public assets

# I. Summary of Findings

## SUMMARY OF PROPOSED MODIFICATIONS

*Many of the issues and concerns raised in the Blackstone Initial Report, the Blackstone Compensation Report and in subsequent discussions with the Company have been addressed in the Amended Form A Filing. However, there remain a number of outstanding issues with respect to Transaction fairness that continue to raise concern and have not been fully addressed. Blackstone would propose the modifications outlined in the table below.*

Document / Section	Proposed Modifications	Comments / Observations
<b>Plan of Conversion</b> "Access" Definition	<i>The Washington Foundation and the financial advisor to the OIC should receive the preliminary proposal detailing the proposed IPO parameters (size, pricing range, split between primary and secondary shares) from Premera and its advisors at least 4 weeks prior to the commencement of the IPO roadshow.</i>	<ul style="list-style-type: none"> <li>■ The financial advisor to the Washington Foundation requires sufficient time in order to evaluate the information provided by the Company and to assist the Washington Foundation in determining its level of participation in the IPO.</li> <li>■ Certain IPO terms could potentially have an impact on transaction fairness. The financial advisor to the OIC needs adequate time to review these terms and incorporate them into its analysis of the overall fairness of the transaction. This is important as the financial advisor to the OIC will likely be asked to provide a bring-down opinion at or around the closing date of the Transaction.</li> </ul>
<b>Plan of Conversion</b> Section 4.3	<i>The Plan of Conversion should include the IPO as a closing condition for the overall Transaction.</i>	<ul style="list-style-type: none"> <li>■ The fairness of the Transaction could be meaningfully impacted if an IPO does not occur simultaneously with the conversion of Premera from a non-profit to a for-profit entity.</li> </ul>
<b>Plan of Conversion</b> Section 4.3(b)(i)	<i>The window to complete an IPO after receiving all regulatory approvals should be twelve months unless the Washington State Commissioner of Insurance ("Washington Commissioner") grants an extension in his sole discretion. The automatic three-month extensions for pending litigation should be removed.</i>	<ul style="list-style-type: none"> <li>■ Twelve months represents an adequate window for Premera to complete an IPO based on a consideration of prior conversions and the potential for equity market dislocations.</li> <li>■ After twelve months, if an IPO has not been completed, the Washington Commissioner should be able to review the facts and circumstances to determine if an extension is warranted.</li> </ul>
<b>Plan of Conversion</b> Section 4.3(b)(ii)	<i>The bring-down certificate language in the Plan of Conversion should be modified so that it requires (i) a disclosure from Premera if its RBC ratio increases or decreases by 25 percentage points or more and (ii) a change in the recommendation of any other consultants to the Company (including legal counsel).</i>	<ul style="list-style-type: none"> <li>■ A change in the Company's RBC ratio of more than 25 percentage points could represent a material change in the Company's financial position and should be disclosed to the Washington OIC and its advisors. Similarly, a change in the recommendation of Premera's legal counsel is a significant event. Such changes would need to be factored into Blackstone's bring-down opinion given that it may impact the fairness of the overall Transaction.</li> </ul>

# I. Summary of Findings

## SUMMARY OF PROPOSED MODIFICATIONS (CONT'D)

Document / Section	Proposed Modifications	Comments / Observations
<b>Plan of Conversion</b> Section 5.3(b)	<i>The Plan should expressly state that the financial advisor to the OIC should be permitted to share its findings and analysis with the Washington Foundation.</i>	<ul style="list-style-type: none"> <li>■ The Washington Foundation has no right to appoint an underwriter in the IPO.</li> <li>■ As a result, the Washington Foundation will be relying on the information obtained from the financial advisor to the OIC.</li> </ul>
<b>VTA<sup>(1)</sup></b> "Change of Control" Definition	<i>The Washington Foundation should be permitted to vote freely on large stock acquisitions by the Company or merger-of-equal transactions (i.e., any transaction that could result in Premera owning less than 80% of the pro forma entity).</i>	<ul style="list-style-type: none"> <li>■ The current provision only allows the Washington Foundation to vote on stock transactions if Premera shareholders' pro forma ownership would be less than 50%. This would potentially exclude merger of equal transactions and large stock acquisitions.</li> <li>■ The Washington Foundation should be able to vote on material transactions as they could have a significant impact on the value of its stake in the Company.</li> <li>■ NYSE stock exchange rules currently require a shareholder vote for any transactions that would result in Premera's shareholders' pro forma ownership to be less than 80%.</li> </ul>
<b>VTA</b> Section 3.02	<i>The Washington Foundation should be allowed to maintain 5% of the outstanding common stock outside the trust at all times. Also, the voting trust should cease to apply to Washington when it drops below 5% ownership within the trust.</i>	<ul style="list-style-type: none"> <li>■ Since the Washington Foundation is a separate shareholder the 5% provision and the cessation of the voting trust at levels below 5% should apply to it individually.</li> <li>■ While the documents currently provide that the Washington Foundation will be permitted to hold 5% outside of the trust, this provision has been conditioned upon the approval of the Blue Cross Blue Shield Association ("BCBSA"). This conditionality should be eliminated.<sup>(2)</sup></li> </ul>
<b>VTA</b> Section 4.03(c)	<i>The Washington Foundation should be permitted to vote freely on (i) any New Stock-Based Programs that are effective during the Stock Restriction Period and (ii) programs that are effective after the Stock Restriction Period and submitted for a vote earlier than six months prior to the end of the Stock Restriction Period.</i>	<ul style="list-style-type: none"> <li>■ Any new stock-based program that becomes effective during the Stock Restriction Period could impact the provisions related to equity compensation that are reflected in the Amended Form A Filing. As a result, the Washington Foundation should have the ability to vote freely on such proposals.</li> <li>■ For plans effective after the Stock Restriction Period, a six-month window should give the Company sufficient flexibility to put such plans into place in advance of the Stock Restriction Period ending.</li> </ul>
<b>VTA</b> Section 5.03(b)(i)	<i>The Washington Foundation should have the right to nominate its own representative to the Company's board of directors.</i>	<ul style="list-style-type: none"> <li>■ A board representative jointly nominated with Alaska raises significant concerns.               <ul style="list-style-type: none"> <li>● Washington and Alaska are two separate shareholders with distinct goals and obligations.</li> <li>● Given that the Washington Foundation will have a substantial ownership interest in the Company, it is important that the Washington Foundation have appropriate representation on the Company's board of directors.</li> </ul> </li> </ul>

(1) "VTA" represents the Voting Trust and Divestiture Agreement.

(2) Under the current documents, if the BCBSA does not permit each Foundation to hold 5% outside the trust and if the Washington and Alaska Foundations can't agree on how to split a single 5% outside the trust, then only the Washington Foundation will have 5% outside the trust.

# I. Summary of Findings

## SUMMARY OF PROPOSED MODIFICATIONS (CONT'D)

Document / Section	Proposed Modifications	Comments / Observations
VTA Section 5.03(b)(i)	<i>Premera should be required to choose one of the three nominees for a Board seat that the Washington Foundation submits.</i>	<ul style="list-style-type: none"> <li>■ The qualification requirements outlined in Section 5.03(b)(i) of the VTA are fairly rigorous and should be the determining factor as to whether someone is qualified to serve on Premera's Board.</li> <li>■ The Company should not have a veto right on all three of the Washington Foundation's nominees if they meet such qualification requirements.</li> </ul>
VTA Section 5.03(b)(ii)	<i>The Washington Foundation's right to designate a board member should not terminate automatically after five years.</i>	<ul style="list-style-type: none"> <li>■ It is possible that the Washington Foundation could continue to maintain a significant ownership percentage after five years (i.e., as much as 50% in some cases).<sup>(1)</sup></li> <li>■ It would be problematic for the Washington Foundation to be a significant shareholder without sufficient Board representation.</li> </ul>
VTA Section 7	<i>The BCBSA divestiture deadlines should apply to the Washington and Alaska Foundations individually rather than in the aggregate. In addition, the divestiture requirement for the first year should be eliminated as was done in the WellChoice conversion.</i>	<ul style="list-style-type: none"> <li>■ The Washington and Alaska Foundations will be separate entities with their own objectives.</li> <li>■ Moreover, the treatment of the Foundations as one shareholder in order to meet the divestiture guidelines would result in a number of potential issues, including but not limited to:               <ul style="list-style-type: none"> <li>● A need to revisit the allocation of demand rights between the Washington and Alaska Foundations, which have been negotiated assuming that the divestiture deadlines would apply individually.</li> <li>● The mechanism requiring the sale of shares in the event a divestiture deadline is not met.</li> </ul> </li> <li>■ The plan currently includes no deadline in year one, subject to the BCBSA approval. This conditionality should be removed.</li> </ul>
VTA Section 10	<i>The VTA should be modified so that if Premera were to lose its Blue Cross Blue Shield ("BCBS") license, the terms of the agreement would be modified so that it is substantially similar to the relevant provision in the WellChoice Transaction.</i>	<ul style="list-style-type: none"> <li>■ The restrictions placed on the Washington Foundation in the VTA are due to the requirements of the BCBSA. A large shareholder of a publicly traded entity would ordinarily not be subject to these types of restrictions. Correspondingly, in the absence of the BCBSA requirements, these restrictions should expire.</li> </ul>

<sup>(1)</sup> Given that the Washington Foundation may be subject to Blackout Periods of up to 730 days in the first five years after the IPO, the Washington Foundation may not need to be below 20% until the seventh year after the IPO.

# I. Summary of Findings

## SUMMARY OF PROPOSED MODIFICATIONS (CONT'D)

Document / Section	Proposed Modifications	Comments / Observations
RRA Section 3(f)	<i>The Washington Foundation should be permitted, to the fullest extent possible, to continue a registration by the Company in which Premera has decided to withdraw.<sup>(1)</sup></i>	<ul style="list-style-type: none"> <li>■ The Registration Rights Agreement ("RRA") does not adequately compel the Company to continue a registration under these circumstances.</li> <li>■ The inability to continue a registration would delay the Washington Foundation's ability to monetize some of its shares since it would have to commence a new registration statement.</li> </ul>
RRA Section 9	<i>In a Washington Foundation Demand where the Company piggybacks, the Washington Foundation's Board should have input in the pricing decision.</i>	<ul style="list-style-type: none"> <li>■ In all circumstances where it is initiating a Demand Right, the Washington Foundation should have the right to influence pricing decisions in order to ensure that it can satisfy its financial objectives.</li> </ul>
PREMERA Bylaws Section 4	<i>The definition of "Independence" for Premera's board of directors needs to be adjusted. Specifically, the 2% of revenue test should be modified (i.e., a company that accounts for 2% of Premera's revenues or that Premera accounts for 2% of such company revenues).</i>	<ul style="list-style-type: none"> <li>■ Due to the VTA, in many instances the Washington Foundation's shares will be voted as directed by the independent directors. As such, it is important to ensure that such directors are truly independent from Premera.</li> <li>■ A company accounting for 2% of Premera's revenues would generate \$57 million<sup>(2)</sup> in total revenues and could potentially be a significant contributor to Premera's earnings.</li> </ul>

<sup>(1)</sup> A potential modification of Section 3(f) would permit the Washington Foundation to continue a registration by the Company, in which Premera has withdrawn, to the extent permitted by law. In addition, the Company would utilize its best efforts to maintain such a registration.

<sup>(2)</sup> Based upon 2003 revenue on a premium and premium fees basis of \$2,834 million.

## I. Summary of Findings

### UNALLOCATED SHARES ESCROW AGENT AGREEMENT

*Premera has included in the Amended Form A Filing a new document, the Unallocated Shares Escrow Agent Agreement ("USEA"). This document stipulates that, to the extent Washington and Alaska are unable to agree upon the allocation of Premera's shares between the Foundations, a portion of the Company's shares shall be placed in escrow until a final agreement on allocation can be reached. While Blackstone understands that this agreement may be necessary if the Foundations are unable to reach an agreement as to allocation, the USEA presents several issues.*

- The USEA is unclear with respect to determining how many shares would be included in the escrow. A detailed mechanism should be reflected in the document in order to determine the amount of shares in the escrow.
- The USEA as currently drafted requires the escrow agent to sell the escrow shares at the IPO (up to 10% of total holdings for both Foundations) to the extent the Foundations have not sold at least 10% of their total holdings in the IPO.
  - The Foundations should be allowed to decide their respective levels of participation in the IPO without any restrictions.
  - Such a provision which forces the Foundations to sell their shares in the IPO, either directly or indirectly through shares in the escrow, raises significant concerns.
- The process by which the escrow agent is selected remains unclear and needs greater detail.
- The timing of the sale of any unallocated shares in the escrow relative to Foundation shares outside of the escrow needs to be further discussed.
- The USEA also requires that the Foundations must jointly agree on how to vote shares in the escrow on matters submitted to a shareholder vote for which "free voting" applies.
  - To the extent the Foundations are unable to agree, the shares in the escrow would be voted as per the recommendation of Premera's independent directors.
  - Such a circumstance essentially limits the Foundations' ability to vote freely and is further complicated by the lack of a process for the Foundations to reach a joint decision.

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## **II. Status of Issues Raised in Original Reports**

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## II. Status of Issues Raised in Original Reports

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### OVERVIEW

- Outlined in the following pages are matrices which summarize: (i) relevant issues raised in Blackstone's original reports, (ii) Premera's revisions to the Transaction which address those issues as reflected in the Amended Form A Filing, and (iii) suggested modifications to address the remainder of our original concerns.
- We have also summarized additional issues that have arisen as a result of our discussions with the Company and our review of the Amended Form A Filing.
- The matrices are divided into the following sections:
  - Rationale for Business Case
  - Valuation Issues
  - Form A Documents
    - Voting Trust and Divestiture Agreement
    - Registration Rights Agreement
    - Management Equity Incentive Plan and Exhibit G-10
  - Other Issues
- The following discussion represents Blackstone's perspective on the substantial issues related to the revised Transaction and may not reflect other matters that (i) may have been raised in our discussions with the Company and subsequently resolved, (ii) represent drafting errors and (iii) do not present significant issues.



## II. Status of Issues Raised in Original Reports

### RATIONALE FOR BUSINESS CASE

Issue	Revision	Comments / Additional Modifications
<i>Premera's Need for \$100–\$150 million of Capital in the IPO (see page 6 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ Section 2(i)(b) of the Registration Rights Agreement has been revised to state that in the case of an IPO, the amount and allocation (as between the Company and the Foundation) of securities to be included in the IPO shall be determined by the Company in consultation with The Foundation and its advisors and in accordance with Section 5.3b of the Plan of Conversion.</li> <li>■ Section 5.3(b) of the Plan of Conversion has been revised to allow the financial advisor to the Washington Foundation access to sufficient information in order to prepare an IPO procedures opinion for the benefit of their respective insurance commissioners and attorneys general in order to assess that IPO has been conducted in a customary manner.</li> </ul>	<ul style="list-style-type: none"> <li>■ This revision allows the Washington Foundation an opportunity to ensure that the IPO does not result in a capital raise in excess of a reasonable amount for the Company while protecting against excessive dilution.</li> <li>■ In addition, the Washington Foundation would be able to determine to what extent it would be prepared to participate in the IPO through the sale of a part of its equity holdings.</li> <li>■ An additional provision should be added to the Plan which requires the Company to make a preliminary proposal regarding contemplated IPO parameters (size, split between primary and secondary shares, and pricing range) to the OIC and its advisors at least 4 weeks prior to the start of the IPO roadshow.</li> <li>■ Also, section 5.3(b) of the Plan of Conversion should be modified to expressly permit the Washington Foundation to have access to Blackstone and its analyses.</li> </ul>
<i>Dilution of the Washington Foundation due to the IPO (see page 7 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The same mechanism described above in "Premera's Need for \$100–\$150 million of Capital in the IPO" addresses this issue.</li> </ul>	<ul style="list-style-type: none"> <li>■ See "Premera's Need for \$100–\$150 million of Capital in the IPO" above.</li> </ul>
<i>Potential Negative Consequences of Converting (see page 7 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ No change.</li> </ul>	<ul style="list-style-type: none"> <li>■ The issues discussed in the Blackstone Initial Report continue to remain relevant.</li> <li>■ No change to the plan is required; however, these issues need to be considered in the context of the entire plan.</li> </ul>

## II. Status of Issues Raised in Original Reports

### VALUATION ISSUES

Issue	Revision	Comments / Additional Modifications
<i>Fairness of the Transaction at the Time of the IPO (see pages 8 and 9 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ As described in Section 4.3(b)(ii) of the Plan of Conversion, the Company will be required to provide a bring-down certificate at the closing date disclosing any material change in a number of specified areas.</li> </ul>	<ul style="list-style-type: none"> <li>■ This bring-down provision will enable Blackstone to monitor, review and assess developments from our February 27, 2004 report through the IPO date, which will enable Blackstone to provide a bring-down opinion, if warranted.</li> <li>■ The bring-down provision should be modified to include any change in the Company's RBC ratio greater than 25 percentage points (versus 50 percentage points currently) and any changes in the recommendation of all consultants to the Company, including legal counsel (currently limited to Premera's investment banking and financial consultants).</li> <li>■ In addition, the closing of the Company's IPO should be added as a closing condition to the Plan of Conversion as the completion of an IPO is an important factor in Blackstone's fairness determination.</li> </ul>
<i>Fairness of IPO Pricing at Time of the IPO (see page 50 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ Section 5.3b of the Plan of Conversion has been revised to give Blackstone access to the IPO process. The monitoring steps that Blackstone outlined in the Blackstone Initial Report have been incorporated into the Plan of Conversion.</li> <li>■ The revised registration rights agreement now stipulates that the Designated Member will be a member of the Company's pricing committee, which will be responsible for decisions regarding pricing, underwriter discounts and commissions.</li> </ul>	<ul style="list-style-type: none"> <li>■ Blackstone has been advised by the OIC and its legal counsel that an IPO conducted in a reasonable and customary manner could deliver fair market value to the Washington Foundation.</li> <li>■ Blackstone plans to actively monitor the IPO process and to deliver a procedures opinion, if applicable, stating that the IPO was conducted in a manner that is consistent with customary and reasonable practices.</li> </ul>
<i>Tax Related Issues on Valuation (see page 9 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ No Change.</li> </ul>	<ul style="list-style-type: none"> <li>■ Potential Negative Consequences of Converting from Becoming Public (see page 7 of Blackstone Initial Report)</li> </ul>

## II. Status of Issues Raised in Original Reports

### VALUATION ISSUES (CONT'D)

Issue	Revision	Comments / Additional Modifications
<i>Impact of the Loss of the BCBS Mark (see page 9 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"><li>■ The Company has not submitted any changes related to this issue.</li></ul>	<ul style="list-style-type: none"><li>■ Once Premera is public, the loss of the BCBS mark may significantly impair Premera's valuation in the market place.</li><li>■ In addition, the BCBS mark is the driving rationale for many of the restrictions embodied in the VTA.</li><li>■ The VTA should be revised to provide if Premera were to lose the BCBS mark, then the VTA would be terminated.<ul style="list-style-type: none"><li>● WellChoice included a similar provision in its VTA.</li></ul></li></ul>

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – VOTING TRUST AND DIVESTITURE AGREEMENT

Issue	Revision	Comments / Additional Modifications
<p><i>Limited Ability for the Washington Foundation to Vote Freely on Most Matters (see page 10 of Blackstone Initial Report)</i></p>	<ul style="list-style-type: none"> <li>■ The VTA has been modified to enable the Washington Foundation to vote freely on matters that concern amendments to the Initial Equity Incentive Plan, a new Stock-Based Program effective during the Stock Restriction Period (provided such program was submitted earlier than twelve months before the end of the Stock Restriction Period) and an Approved Change of Control Proposal.</li> </ul>	<ul style="list-style-type: none"> <li>■ Under the current documents, the Washington Foundation is only permitted to vote on stock transactions where Premera shareholders own less than 50% of the shares post-transaction.</li> <li>■ This provision should be broadened to give the Washington Foundation the ability to vote freely on major stock acquisitions and merger-of-equals transactions (i.e., any transaction which would result in the shareholders of Premera prior to the transaction owning less than 80% pro forma for the transaction).               <ul style="list-style-type: none"> <li>● Such transactions could have a material impact on the value of the Washington Foundation's ownership stake in Premera</li> </ul> </li> <li>■ In addition, the VTA provision regarding the ability to vote on New Stock-Based Programs needs to be modified so that the Washington Foundation should be allowed to vote freely on:               <ul style="list-style-type: none"> <li>● Any New Stock-Based Program that becomes effective during the Stock Restriction Period</li> <li>● Any New Stock-Based Program effective after the Stock Restriction Period provided that such program was submitted to a vote earlier than six months prior to the end of the Stock Restriction Period</li> </ul> </li> <li>■ As outlined in Section 4.03(e) of the VTA, the independent directors will vote the Washington Foundation's shares under the current plan in many situations. Thus, it will be important to ensure that each director is truly independent from Premera. (See Form A Documents – Other Issues)</li> </ul>

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – VOTING TRUST AND DIVESTITURE AGREEMENT (CONT'D)

Issue	Revision	Comments / Additional Modifications
<i>Lack of Requirement for the Washington Foundation to be Consulted on an Acquisition Proposal or Change of Control Proposal (see page 10 and page 53 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"><li>■ The amendment to the VTA in section 6.01 currently has been revised to allow that the Company will consult with the Washington Foundation on change of control transactions as long as the Foundation owns 20% or more of the outstanding common stock.</li></ul>	<ul style="list-style-type: none"><li>■ None.</li></ul>
<i>The Washington Foundation Would be Principally Responsible for Payments to the Trustee (see page 11 and page 52 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"><li>■ Section 9.03 of the VTA has been revised to reflect that Premera will pay compensation to the Trustee for its services for the first year after the IPO and that thereafter the Company and the Washington Foundation shall share the expense equally.</li></ul>	<ul style="list-style-type: none"><li>■ None.</li></ul>

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – VOTING TRUST AND DIVESTITURE AGREEMENT (CONT'D)

Issue	Revision	Comments / Additional Modifications
<i>Lack of the Washington Foundation Representation on Premera's Board of Directors (see page 10 and page 11 of Blackstone's Initial Report)</i>	<ul style="list-style-type: none"> <li>■ Section 5.03(b) of the VTA has been revised to allow the Washington and Alaska Foundations to jointly nominate one Designated Member for election to Premera's Board of Directors as long as the Foundations own 5% of the outstanding common stock but no more than five years from the Transaction Effective Date.</li> <li>■ In addition, the Designated Member will have committee representation during the first three years on the Company's executive, pricing and compensation committees.</li> <li>■ Under the current documents, the Washington and Alaska Foundations will jointly submit three candidates for consideration (given certain qualifications as set forth in the VTA), and Premera has the ability to reject all three candidates presented.<sup>(1)</sup></li> </ul>	<ul style="list-style-type: none"> <li>■ Given its significant ownership and independence from the Alaska Foundation, the Washington Foundation should have the right to nominate its own Designated Member.</li> <li>■ The Company should not have a veto right over the Washington Foundation's Board of Director selection. <ul style="list-style-type: none"> <li>● The Company should only be able to reject all of candidates presented if they do not meet the required qualifications as outlined in the VTA.</li> <li>● Otherwise, Premera should be required to select one of the three candidates submitted by the Washington Foundation.</li> </ul> </li> <li>■ Also, the five year limitation on the Washington Foundation's Board of Director seat is problematic as it could leave the Washington Foundation with a significant ownership interest (i.e., 50% under certain circumstances)<sup>(2)</sup> and no board representation.</li> </ul>

<sup>(1)</sup> If Premera rejects all three nominations from the Foundations, then the Foundations will be required to nominate one or more additional nominees who would also be subject to approval by the Board of Directors of Premera.

<sup>(2)</sup> Given that the Washington Foundation may be subject to Blackout Periods of up to 730 days in the first five years after the IPO, the Washington Foundation may not need to be below 20% until the seventh year after the IPO.

Premera Blue Cross

## II. Status of Issues Raised in Original Reports

FORM A DOCUMENTS – VOTING TRUST AND DIVESTITURE AGREEMENT (CONT'D).

Issue	Revision	Comments / Additional Modifications
<i>Divestiture Deadlines Are Restrictive Versus Precedent Transactions (see page 11 and page 52 of Blackstone's Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The divestiture schedule for year three and beyond was extended to conform to the divestiture schedule in the WellChoice conversion: (i) one year after the IPO – 80%; (ii) three years after the IPO – 50%; (iii) five years after the IPO – 20%; and (iv) ten years after the IPO – 5%. <ul style="list-style-type: none"> <li>● The original divestiture schedule was similar in year three but required the Foundations to be below a 5% ownership level six years after the IPO.</li> </ul> </li> <li>■ The new VTA also proposes that the divestiture deadline for one year after the IPO (80%) would be eliminated provided that the Company receives approval from the BCBSA for such elimination.</li> <li>■ Under the Amended Form A Filing, the Washington and Alaska Foundations ownership level would be analyzed in the aggregate for purposes of meeting the divestiture deadlines.</li> </ul>	<ul style="list-style-type: none"> <li>■ Given that the Washington and Alaska Foundations will represent two separate shareholders of the Company (with separate ownership and Boards), it is unclear why their ownership levels would be treated in aggregate for the purposes of meeting the BCBSA divestiture deadlines.</li> <li>■ The divestiture deadlines should apply individually for the Washington and Alaska Foundations so that Washington would only have to meet the ownership deadlines based on the shares it owns and controls.</li> <li>■ In addition, the divestiture deadline in the first year after the IPO (80%) should be eliminated as it was in WellChoice.</li> </ul>
<i>Proper Indemnification of the Trustee (see page 11 of Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The Company will indemnify the Trustee except in cases in which there is gross negligence or willful misconduct and where the Trustee's actions arose from express written instructions from the Washington Foundation.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Premera's Observations Rights on the Foundation's Board (see page 11 of Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The VTA has been revised to eliminate this provision.</li> </ul>	<ul style="list-style-type: none"> <li>■ None</li> </ul>

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – VOTING TRUST AND DIVESTITURE AGREEMENT (CONT'D)

*The following issues relating to the VTA were raised during our conversations with the Company since October 2003 or relate to new issues arising from the Amended Form A filing.*

- Under the new transaction structure, there are two separate Foundations as opposed to one Foundation Shareholder. As discussed earlier, although the Foundations are two separate shareholders, the revised VTA treats the two Foundations as one for the purposes of meeting the BCBS divestiture deadlines. This raises several potential issues:
  - Both Foundations will have ownership and boards with differing financial objectives. Aggregating the Foundations' ownership for meeting the divestiture deadlines may force a Foundation to alter its intentions due to the actions of the other Foundation.
  - To the extent that one Foundation meets its divestiture deadlines while the other Foundation does not, the forced sale mechanism in the VTA would require both Foundations to sell shares.
- According to the VTA, each Foundation will be permitted to hold 5% of the outstanding common stock of the Company outside the Voting Trust. However, the VTA also provides that if the BCBSA were to restrict the ability of the Foundations to be treated separately, the 5% outside the trust would apply in aggregate to both Foundations.
  - Since the Washington Foundation is an individual shareholder completely separate from Alaska, it should be allowed to hold 5% of its shares outside of its Voting Trust.
  - Since the BCBSA regulations allow that a single shareholder may own 5% or less of the Company's common stock outstanding and since the Washington Foundation and the Alaska Foundation are two separate shareholders, each Foundation should be able to comply with BCBSA license requirements while maintaining 5% outside the trust, respectively.



Premera Blue Cross

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – REGISTRATION RIGHTS AGREEMENT

Issue	Revision	Comments / Additional Modifications
<i>No Restrictions on When Demand Registration Rights Would Begin (see page 54 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The Washington Foundation would be initially restricted from initiating a demand registration for 180 days following the IPO.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Premera is not Required to Register Demand Rights if (i) the Foundation or the Company Registered Shares in Previous 180 Days and (ii) the Foundation had Previously Executed a Demand Right in a Calendar Year (see page 12 and page 53 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ Premera is not required to register a Washington Foundation demand right when the Company had effected a Demand Registration Right or a registration of common stock sold by the Company in the previous 120 days (formerly 180 days).</li> <li>■ In addition, the Washington and Alaska Foundations are restricted from executing more than two demands in a calendar year in the 54 months following the initial 180-day lock-out period and no more than one demand per calendar year thereafter. Formerly the Foundations collectively were given only one demand right per year.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Certain Elements of the Company's Option to Buy Back the Foundations' Shares May Limit the Foundation's Ability to Maximize the Value of Its Holdings in Premera (see page 12 of Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The RRA no longer provides that the Company will have an option to purchase shares held by the Washington Foundation except in connection with a Demand Registration.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>

## Premera Blue Cross

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – REGISTRATION RIGHTS AGREEMENT (CONT'D)

Issue	Revision	Comments / Additional Modifications
<i>The Washington Foundation Is Restricted to Sale of Common Stock under Rule 144 Until Premera Has Received Proceeds Representing 25% of the Company (see page 13 and page 55 of Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The Washington Foundation may sell any registrable securities pursuant to Rule 144 provided the Company has established a public float of at least \$50 million.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Premera's Right of First Refusal in a Private Placement Would Adversely Affect the Foundation's Ability to Execute Private Placements (see page 13 and page 55 of Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The RRA has been amended to provide that the Company has the right of first offer in a private placement versus the right of first refusal in the original version.</li> <li>■ Premera will have the option to purchase any shares intended to be sold through a private placement provided the Washington Foundation gives written notice to Premera and that the Company respond with its decision in no later than 15 days.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Premera's Holdback Period of 30 Days during which the Company Would Not Sell Securities after Registration for an Underwritten Demand Offering by the Foundation is Less than the Period Stipulated in WellChoice (see page 13 and page 55 of Initial Report)</i>	<ul style="list-style-type: none"> <li>■ Premera extended the holdback period to 60 days.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>

## II. Status of Issues Raised in Original Reports

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### FORM A DOCUMENTS – REGISTRATION RIGHTS AGREEMENT (CONT'D)

*The following issues relating to the Registration Rights Agreement were raised during our conversations with the Company since October 2003 or relate to new issues arising from the amendments to the Form A filing.*

- In the original Form A filing, the Washington Foundation had limited ability to select an underwriter representative in connection with a registration in which a Foundation would be participating.
  - The registration rights agreement now provides that in a demand registration, the demanding Foundation has the right to select the joint-book-runner (and stabilization agent), the Company has the right to select the other joint book-runner, and the joining Foundation (if applicable) has the right to select a co-lead manager or co-manager (as appropriate).
  - In a Company registration, the Company will select a joint book-runner (and stabilization agent) and the piggy-backing Foundation that is selling a larger share than the other Foundation will be able to select a joint book-runner while the second Foundation may choose a co-manager.
  - Blackstone believes this is an acceptable provision.
- Blackstone would propose that Section 9 of the RRA be revised such that the Washington Foundation's Board or Pricing Committee will have input on determinations regarding pricing, underwriter discounts and commissions in circumstances in which the Company is participating in a Washington Foundation Demand.
  - Currently, in this scenario, the Company's Pricing Committee would control these decisions in its sole discretion.

## II. Status of Issues Raised in Original Reports

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### FORM A DOCUMENTS – REGISTRATION RIGHTS AGREEMENT (CONT'D)

- The RRA does not adequately allow the Washington Foundation to continue a Company registration in which Premera has decided to withdraw. Such a restriction could result in a delay in a Foundation's ability to effect a registration despite the existence of a previous Company registration in which the Foundations were participating.
  - As described in this agreement, in a case of a registration by the Company where Premera plans to withdraw the filing, the Company is obligated to give the Foundations three days notice whereby it may request the Company to use its best efforts to continue the piggy-back registration by the Foundations.
  - The Company should allow the Foundations to continue a registration filing by the Company for the sale of securities as a demand right in the event that the Company withdraws.
  - This language in the registration rights agreement does not sufficiently compel the Company to continue the registration.
- The Registration Rights Agreement has been amended to include provisions that detail the allocation of the demand rights between the Washington and Alaska Foundations.
  - The Washington Foundation shall retain all rights pertaining to demand registrations except as restricted by Alaska's rights:
    - The Alaska Foundation will have one demand right from the IPO to the third anniversary of the IPO date.
    - The Alaska Foundation will have one demand right from the third anniversary of the IPO date to the fifth anniversary of the IPO date provided that it shall receive an additional demand right if the Washington Foundation's ownership level became less than 20% during this time and the Alaska Foundation ownership level exceeded 5%.
    - The Alaska Foundation shall have one demand right from the fifth anniversary of the IPO date to the tenth anniversary of the IPO date provided that it shall receive an additional demand right if the Washington Foundation's ownership level became less than 5% during this time and the Alaska Foundation ownership level exceeded 3%.
  - The allocation of demand rights between the Washington and Alaska Foundations was developed assuming that the VTA divestiture deadlines would apply individually for each Foundation.
  - To the extent that the Foundations are treated in the aggregate for the purposes of meeting the divestiture deadlines (and as currently proposed in the revised VTA), the Washington Foundation is likely to face a greater need to sell a larger amount of its shares more frequently. As such, the mechanics detailing the allocation of demand rights between the two Foundations may not be appropriate.

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – MANAGEMENT EQUITY INCENTIVE PLAN

*Subsequent to Blackstone's initial report on the Transaction, Blackstone prepared a report reviewing Premera's management equity incentive plan dated November 24, 2003 based upon material provided by the Company on October 17, 2003. The following review should be considered in conjunction with this report.*

Issue	Revision	Comments / Additional Modifications
<i>Initial Eligibility of Officers and Directors for Option Grants Would Begin Only Three Months after the Transaction Effective Date (See page 1 of Blackstone Compensation Report)</i>	<ul style="list-style-type: none"> <li>■ Exhibit G-10 has been revised to prohibit initial grants to officers and directors for a period of twelve months following the IPO, which is consistent with WellChoice and selected other conversions / demutualizations.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Ability of Officers and Directors to Purchase Shares in the IPO (see page 1 of Blackstone Compensation Report)</i>	<ul style="list-style-type: none"> <li>■ The Company's officers and directors will not be allocated shares as part of the IPO and will not be able to purchase shares of the Company on the open market until 45 days after the IPO.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – MANAGEMENT EQUITY INCENTIVE PLAN (CONT'D)

Issue	Revision	Comments / Additional Modifications
<i>Establishing a Longer Period of Time for Which Limitations Related to Equity Incentive Plan Would Apply (see page 2 of Blackstone Compensation Report)</i>	<ul style="list-style-type: none"> <li>■ Exhibit G-10 and the Equity Incentive Plan now propose a Stock Restriction Period<sup>(1)</sup> for a period of three years following the IPO (vs. two years previously).</li> <li>■ Any amendments/modifications to the management stock compensation plan<sup>(1)</sup> during this three year period would require a shareholder vote where the Washington Foundation could vote its shares freely as detailed in the VTA.</li> <li>■ Additionally, the Designated Member will serve on the Compensation Committee during the Stock Restriction Period.</li> </ul>	<ul style="list-style-type: none"> <li>■ Please see comments on the VTA review titled "Limited Ability for the Washington Foundation to Vote Independently on Most Matters".</li> </ul>
<i>Lack of Annual Limitations on Premera's Ability to Make Grants (see page 2 of Blackstone Compensation Report)</i>	<ul style="list-style-type: none"> <li>■ The Company has amended Exhibit G-10 to include annual limits on the total grants available under the share reserve in the second and third year after the IPO of 1.66% of the common stock outstanding.<sup>(2)</sup></li> <li>■ Exhibit G-10 has also been amended to include a limitation on grants under the LTIP<sup>(3)</sup> of 0.67% in the second and third year in the aggregate.</li> <li>■ The reserve pool has been created that can only be used for grants for new hires and directors, newly promoted employees/officers and high-performing officers/employees subject to annual limitations during the Stock Restriction Period.<sup>(4)</sup></li> <li>■ Additionally, the Designated Member will serve on the Compensation Committee (see above).</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>

<sup>(1)</sup> Management's stock compensation plan is reflected in the Equity Incentive Plan and the guidelines described in Exhibit G-10.

<sup>(2)</sup> The allocation of the maximum shares reserved for grants (7%) during the Stock Restriction Period is as follows: 1.55% for a one-time grant to non-executive employees, 3.32% for annual grants in years 2 and 3; 0.67% for LTIP grants in years 2 and 3; and 1.46% for the reserve pool.

<sup>(3)</sup> LTIP represents the Company's Long-term Incentive Plan.

<sup>(4)</sup> The shares for grants in the reserve pool are subject to annual individual and aggregate limitations as follows: (i) grants to individuals shall not exceed 5,000 shares per annum or (ii) 100,000 shares in the aggregate during the Stock Restriction Period.

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – MANAGEMENT EQUITY INCENTIVE PLAN (CONT'D)

Issue	Revision	Comments / Additional Modifications
<i>Lack of Maximum Individual Grants (see page 2 of Blackstone Compensation Report)</i>	<ul style="list-style-type: none"><li>■ In addition to the annual maximum individual grant of 0.5% of the common stock outstanding detailed in the Equity Incentive Plan, the Company has included annual limitations for grants to the Executive Officers during the Stock Restriction Period (i.e., years two and three after the IPO).<ul style="list-style-type: none"><li>● Chief Executive Officer's annual grant cannot exceed 0.17%.</li><li>● The four executive Vice Presidents as of February 5, 2004 shall not receive grants in excess of 0.42% of the common stock outstanding in the aggregate per annum.</li><li>● Together the above five officers may not receive annual grants in excess of 0.59% of the common stock outstanding.</li></ul></li></ul>	<ul style="list-style-type: none"><li>■ None.</li></ul>

## II. Status of Issues Raised in Original Reports

### FORM A DOCUMENTS – OTHER ISSUES

Issue	Revision	Comments / Additional Modifications
<i>Premera's Plan to Institute a Shareholder Rights Plan is Inconsistent with Precedent Conversions (see page 14 and page 59 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ The Company has eliminated the proposed shareholder rights plan (e.g., "Poison Pill") from its revised Form A.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>The Foundation Will Indemnify the Company for the Loss of Any Tax Attributes Resulting from the Transaction (see page 13 of Blackstone Initial Report)</i>	<ul style="list-style-type: none"> <li>■ Premera has eliminated the tax indemnification that the Company would have received with which the Foundations could have incurred significant economic losses due to the loss of any tax attributes after the closing of the Transaction.</li> </ul>	<ul style="list-style-type: none"> <li>■ None.</li> </ul>
<i>Need to Ensure that the Company's "Independent" Directors are Truly Independent from Premera</i>	<ul style="list-style-type: none"> <li>■ Premera has amended the Bylaws of New PREMERA Corp. to include qualifications for a director to be deemed "Independent" as set forth in Section 4.</li> </ul>	<ul style="list-style-type: none"> <li>■ Due to the VTA, in many instances the Washington Foundation's shares will be voted as directed by the independent directors. As such, it is important to ensure that such directors are truly independent from Premera.</li> <li>■ The definition of "Independence" for Premera's board of directors needs to be adjusted. Specifically, the 2% of revenue test should be modified (i.e., a company that accounts for 2% of Premera's revenues or that Premera accounts for 2% of such company revenues).</li> <li>■ A company accounting for 2% of Premera's revenues would generate \$57 million<sup>(1)</sup> in total revenues and could be a significant contributor to Premera's earnings.</li> </ul>

<sup>(1)</sup> Based upon 2003 revenue on a premium and premium fees basis of \$2,834 million.



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## **Appendices**

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## **A. Update of Recent Premera Operating Results**

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## A. Update of Recent Premera Operating Results

### PREMERA ACTUAL AND BUDGETED FINANCIAL PERFORMANCE

(\$ in millions)

	2003 <sup>(1)</sup>			2004 <sup>(2)</sup>		
	Budget	Actual	Variance	Budget	Adjustment	Revised Budget
Total Revenue <sup>(3)</sup>		\$2,833.5				
Contribution Margin		409.3				
Operating Income <sup>(4)</sup>		48.1				
Net Income	Proprietary Material Redacted	53.7		Proprietary Material Redacted		
Medical Loss Ratio		84.1%				
S,G&A Expense Ratio		16.5%				

<sup>(1)</sup> Premera year-end 2003 financial and operational performance reports provided February 17, 2004.

<sup>(2)</sup> Premera 2004 budget materials prepared for the Board of Directors dated February 11, 2004.

<sup>(3)</sup> Revenue on a premium and premium fees basis.

<sup>(4)</sup> Operating Income = Earnings before Interest, Taxes, Net Investment Income, and Net Realized Gains and Losses.

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## **B. Letter Regarding Fairness of Transaction**

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# The Blackstone Group®

## DRAFT - CONFIDENTIAL

February 21, 2004

The Honorable Mike Kreidler  
Washington State Insurance Commissioner  
Office of Insurance Commissioner  
Turnwater, Washington 98501

Dear Commissioner Kreidler:

Premera Blue Cross (the "Company") intends to convert from a Washington non-profit health service company into a for-profit stock company ("New PREMERA") (the "Conversion"). It is contemplated that the Conversion will be carried out pursuant to the Plan of Conversion as filed in the Form A Statement Regarding the Acquisition of Control of a Domestic Health Carrier and a Domestic Insurer on September 17, 2002, as amended on February 5, 2004 (the "Plan"). You have asked us whether, in our opinion, the proposed Plan, taken as a whole, is fair to policyholders, health care providers and the public, from a financial point of view. With your permission, we defer to PricewaterhouseCoopers as to the fairness of the proposed Plan, taken as a whole, to policyholders and health care providers. Capitalized terms used and not defined herein have the meanings given to them in the Plan.

The Plan provides, among other things, that (i) the Company will create a new for-profit subsidiary ("New PBC") to which the Company will transfer all its assets in exchange for 100% of New PBC stock; (ii) the Company will dissolve and distribute its assets (composed of 100% of the initial stock of New PBC) to PREMERA, its corporate member; (iii) PREMERA, a not-for-profit company, will create a new for-profit subsidiary, New PREMERA, to which PREMERA will transfer all its assets (composed of 100% of New PBC's stock) in exchange for 100% of New PREMERA's stock; and (iv) PREMERA will dissolve and distribute its assets (composed of 100% of the initial stock of New PREMERA) to two newly formed foundations established to fund support for health initiatives in Washington (the "Washington Foundation") and Alaska (the "Alaska Foundation"; collectively with the Washington Foundation, the "Foundations"), respectively. After completion of the reorganization, the Foundations would hold 100% of the initial stock of New PREMERA, representing the entire ownership interest of New PREMERA at the conclusion of the reorganization. The Foundations' shares in New PREMERA would be sold in the public markets, subject to a divestiture schedule consistent with Blue Cross Blue Shield Association rules and pre-agreed terms established between New PREMERA and the Foundations, with approval of the regulatory authorities. New PREMERA would have the right to issue and sell newly issued shares of New PREMERA, at its discretion, with proceeds going directly to New PREMERA to fund ongoing capital needs of the Premera companies.

We have, among other things:

- Reviewed a copy of the Plan;
- Reviewed the Company's audited historical financial statements for the years ended December 31, 1997 – 2002 and unaudited financial statement for the year ended December 31, 2003;
- Reviewed the Company's statutory historical financial statements for the years ended December 31, 1997 – 2002;
- Reviewed the Company management's projections for the years 2003 – 2007;
- Reviewed the Company management's revised financial outlook for 2003 – 2006;
- Reviewed the Company management's revised 2004 budget;
- Reviewed minutes from meetings of the Company's board of directors for the years 1997 – 2003;
- Reviewed the Form A Statement Regarding the Acquisition of Control of a Domestic Health Carrier and a Domestic Insurer and transaction documents related to the Conversion, dated September 17, 2002, and as amended on February 5, 2004;
- Reviewed presentations made by Goldman Sachs, including those dated September 10, 1997, November 12, 1997, September 9, 2000, May 24, 2001, August 8, 2001 and October 6, 2002;
- Reviewed the initial reports analyzing various aspects of the Transaction prepared by the consultants/advisors representing the State of Washington Office of Insurance Commissioner ("OIC"), the Alaska Department of Insurance ("ADI") and the Company;
- Reviewed drafts of the Washington Representatives' supplemental reports analyzing various aspects of the revised Transaction;
- Reviewed certain other publicly available and internal information concerning the business, financial condition and operations of the Company that we believe to be relevant to our inquiry;
- Held discussions on several occasions with both the advisors and the members of Premera's management concerning the original Form A Filing to review and discuss concerns raised in the reports of the consultants to Washington and Alaska;
- Held discussions with the OIC, the ADI and their representatives regarding the amended Form A filing submitted on February 5, 2004;
- Held discussions on several occasions with both the advisors to and the members of management of the Company concerning the Company and its business, operating environment, financial condition, prospects, and strategic objectives;
- Held discussions on many occasions with the OIC, the ADI and their other consultants, advisors and counsel concerning the Company and its business, operating environment, financial condition, prospects and strategic objectives;
- Analyzed the market performance of other conversions and initial public offerings in the health insurance industry;

- Analyzed the operating and trading statistics of selected publicly traded managed care companies;
- Prepared and analyzed various sensitivities to management's projections; and
- Reviewed such other information, performed such other studies and analyses, and took into account such other matters as we deemed appropriate.

We have not, among other things:

- Independently verified the accuracy and completeness of financial and other information that is available from public sources and information provided to us by Premera or its respective representatives, or otherwise reviewed by us;
- Made an independent appraisal of Premera's surplus or assets or expressed any opinion as to either the value of such surplus or such assets or the value of the projected income and cash flow expected to be derived therefrom;
- Performed due diligence on Premera's physical properties, sales, marketing, distribution or service organizations, product markets, investment portfolio;
- Examined or incorporated any findings that may be part of documents deemed to be attorney-client privileged as determined by the Special Master's Decision Following In Camera Review of Documents (Docket No. G02-45);
- Considered any documents or analysis submitted by Premera after February 23, 2004;
- Considered any discussions with Premera or its advisors, which took place after February 23, 2004; and
- Expressed any opinion, including as to the following:
  - The fair value of Premera;
  - The fair value of the public assets of Premera that serve health care needs in Washington; and
  - Whether the terms of the Transaction fairly distribute the value of the public assets.

We have identified in our Update Report on Valuation and Fairness of the Proposed Conversion dated February 27, 2004 various deficiencies in the Plan that, taken together, cause us to be unable to opine that, as of the date hereof, the Plan, taken as a whole, is fair to the public from a financial point of view. This opinion is based on our review and analysis of the Plan in its entirety and as a whole and is subject to further consideration and evaluation to the extent that any of the terms and conditions of the Plan are amended, revised or otherwise changed from the date hereof.

Very truly yours,

The Blackstone Group L.P.